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Intelligence Report

Developed Countries: Short-Term Economic Prospects

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ER IR 75-22
December 1975

Copy № 118

Foreword

The forecasts of economic developments in the major foreign developed countries presented in this report are based primarily on judgments of country experts. The judgments are derived from detailed analysis of indicators of economic activity, examination of other assessments, and extrapolation of recent trends and changes in trend.

All forecasts are checked for accounting consistency, either by the analyst or by the project coordinators. The checks help uncover potential conflicts within the forecasts and insure the logical accuracy of the forecasts. They do not, of course, prevent forecast errors resulting from inaccurate exogenous assumptions. The major relationships that are cross-checked include

- changes in production, demand, and inventories;
- changes in disposable incomes, consumption, and savings;
- changes in real GNP, prices, money supply, and velocity;
- growth – on a trade-weighted basis – of each country's export markets and its exports;
- growth – on a trade-weighted basis – of supplier export prices and each country's import prices;
- changes in industrial production, GNP, and implied production of non-industrial goods and services; and
- the relationship that requires the trade balance, and changes in the trade balance, of the world to equal zero.

Developed Countries: Short-Term Economic Prospects

SUMMARY

Recovery in the Big Six foreign economies* will be slow and halting at least through June 1976, the end of our current forecast period. Although the longest and deepest recession of the postwar era appears to be over in at least half of these countries, almost all indicators continue to point to flaccid demand. In all countries, utilization of industrial capacity is low, discouraging investment in plant and equipment. Inventories remain relatively high, holding down investment in stocks. Most important, consumers seem likely to continue high saving rates, limiting gains in household consumption spending. A resurgence in consumer confidence – a particularly nebulous factor to predict – would of course lead to stronger GNP growth than we now anticipate, particularly in West Germany and Japan.

For the current half year, we expect combined real GNP in the Six to grow at an annual rate of 1%; in first half 1976, we expect a 3% rise. This 12-month increment of 2% is exceptionally small for the first year of recovery from a recession.

We expect Japan, France, and Canada to turn in the best performances. Japanese GNP should rise by more than 3.5%, comparing first half 1976 with first half 1975. Although this rate will be well below previous Japanese recoveries, it will be the best of the Six. France may run a close second to Japan, chiefly because of a reduction in the unprecedented inventory drawdowns of early 1975. Canadian GNP in first half 1976 should be 3% above first half 1975 as the result of a strong upturn in housing and the budding recovery of US demand.

Using the same first-half comparison, we foresee less than a 1% rise in GNP in West Germany, stagnant output in Italy, and a continuing decline in the United

* Canada, France, Italy, Japan, the United Kingdom, and West Germany.

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Note: Comments and queries regarding this report are welcomed. They may be directed to of the Office of Economic Research,

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Kingdom. The contraction in real government spending expected early next year is the key to our pessimistic estimate of West German performance. Declining investment in plant and equipment will be the chief depressant in Italy and the United Kingdom.

Inflation, having fallen to a combined rate of 9% for the Big Six, is unlikely to change much through the middle of next year. In recent months, sluggish demand has brought down raw material prices, forced businesses to shave profit margins, and in some cases induced labor to hold down wage demands. Our predicted rise in consumer prices for the Six – 9% annual rate in first half 1976 -- is nevertheless far above historic rates. In first half 1976, West Germany will post the best inflation record, at 6% annually, while Britain will continue to turn in the worst performance. At this time, Japan and Italy are having the most success in cutting back inflation.

We expect the combined current account balance of the Six to deteriorate sharply in the year ending June 1976. This worsening from a small deficit in first half 1975 to a $6.5 billion deficit in second half 1975 and a $7.3 billion deficit in first half 1976 stems largely from a weakening of the trade accounts.

In most countries, swings in merchandise trade positions will be affected more by volume than by price changes. Even though recovery will be sluggish, import volume should pick up considerably in the current half as producers restock deplenished inventories, particularly of oil; the rate of increase in import volume is expected to slow in first half 1976 Export volume should turn up less rapidly than imports because of weaker growth expected in the demand of smaller countries.

The West German current account surplus should decline considerably in coming months. We expect Canada – a deficit country with a strong credit rating – to post the largest deficit, $4.6 billion in the 12 months to mid-1976. We believe that the other Big Six countries – which should register deficits in the $1-$4 billion range – also will face few problems in financing their current account deficits.

DISCUSSION

Recent Developments

1. The current firming in real economic activity in the Big Six foreign economies had its origins in first half 1975, when producers held production below demand to induce substantial inventory reductions. This adjustment – which was much stronger than we and other forecasters had anticipated – helped shear aggregate GNP of the Six by more than 4% in the first half. In absolute terms, Big Six inventories were cut $12 billion (annual rate). Other private investment components – investment in plant and equipment and housing construction – contributed to the drop in GNP. Mild growth in private consumption, government purchases, and exports to countries outside the Six softened the fall. The sharp decline in GNP in the first half followed a meager gain of 0.5% (annual rate) in second half 1974.

2. The rampant inflation of 1973-74 subsided to 9% in second half 1975, from a peak combined rate of 19% in first half 1974. Dampened demand, the comparatively restrictive stance of monetary authorities in second half 1974, and the sobered attitude of some trade unions contributed to the slowdown. Cost pressures on producers were partly relieved by the drop in world raw material prices; international commodity prices fell at a 60% annual rate between mid-1974 and early 1975.

3. Reflecting the sharp curtailment of industrial production and the working down of inventories, import volume plunged at a 13% annual rate in first half 1975. Although tight linkages among the Big Six – 45% of their trade is with one another – meant that export volume fell also, more buoyant sales to countries outside the group held the export decline to 10% (annual rate). These divergent trends in trade volume, combined with favorable movements in terms of trade with the Third World, brought the combined current account deficit down to only $0.6 billion. The small deficit contrasts with the $6.7 billion deficit incurred in second half 1974, when the major countries were still staggering from large oil price hikes.

Weak Upturn in Prospect

4. For second half 1975, we expect the combined GNP of the Big Six to grow at an annual rate of 1%; for first half 1976, we expect a 3% rise. The near-completion of inventory drawdowns earlier this year is removing a big source

of economic drag. Yet we see no demand component strong enough to undergird rapid recovery through mid-1976. We believe that an increase in private consumer demand averaging only 2% annually in first half 1976 will give the upturn most of its impetus. Indicators such as capacity utilization rates and orders for capital goods point toward depressed investment at least through June. Government fiscal efforts are expected to taper off, as officials fret over inflation and budgetary deficits.

5. Although its recovery rate will be slow by past standards, Japan will lead the Big Six (see Figure 1). We expect Japanese GNP to grow at an annual rate of 3% in second half 1975 and 4-1/2% in first half 1976. France should run a close second, with GNP changes fractionally below changes in Japan. A continuation of heavy government spending and a surge in housing demand underlie the anticipated pickup in Japan. The gradual phasing out of massive inventory reductions will ease the drag on French growth starting in second half 1975; confidence imparted by Paris' well-publicized stimulative program should help spark an upturn early next year. Growth in Canadian output also is expected to accelerate in early 1976, aided by spillover from US recovery.

6. West Germany, the second largest producer and the largest importer among the Six, is expected to recover only slowly. German output should grow at an annual rate of 1/2% this half and 1% next half. A contraction in real government spending expected early next year is key to our pessimistic estimate for West Germany. Prospects remain poorest for Italy and the United Kingdom through mid-1976. Declining investment in plant and equipment will contribute to the stagnation of Italian output and to the continued slide in British GNP.

7. Industrial production in the Six should grow at nearly 4% in the 12 months through mid-1976 after plummeting 13% (annual rate) in first half 1975. Producers have been keeping industrial output below demand levels to reduce stocks. Even if we did not expect some strengthening in demand in coming months, industrial production probably would rise slightly as inventory adjustments near an end. In most countries, we expect industrial production to follow closely the pattern of GNP. In Japan, where there has been little statistical relationship between changes in GNP and industrial production in recent half-year periods, we expect that industrial output will initially rise at a much faster pace than final demand.

Government Policy and Purchases: Parsimonious Stimulation

8. A key factor in our prediction of slow recovery is the expectation that fiscal policy will become much less stimulative in 1976. We base this judgment

Figure 1

DEVELOPED COUNTRIES: Percent Changes in Real GNP[1]

[1]Change over previous period, seasonally adjusted, at an annual rate.
[2]Projected

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on indications that the impact of most reflationary programs will be concentrated in the current year and will be diluted in the succeeding period. Several governments intend to add little or nothing to expenditures in real terms next year.

9. Big Six governments rationalize their conservative spending plans for 1976 on the hope that stimulation from various fiscal programs this year and renewed export growth will generate a self-sustaining expansion. Many governments believe that continued rapid growth in outlays in 1976 would constitute an overdose of economic stimulation and would reaccelerate inflation. Our survey of various economic indicators makes us skeptical that the private components of spending will take off vigorously; we feel this governmental strategy will result in disappointing growth.

10. The tapering off in public spending will be most pronounced in West Germany. Real government purchases are expected to grow at an annual rate of 1-1/2% in the current half year, then fall at more than 3-1/2% (annual rate) in first half 1976 as Bonn attempts to reduce its huge budget deficit. Similar patterns are emerging in all of the countries except Italy. For the Six as a group, the expected slowdown in growth of government purchases between second half 1975 and first half 1976 will directly cut half a percentage point from overall GNP growth; multiplier effects will add to the total impact.

11. Monetary factors will partly compensate for the shift toward less expansionary fiscal policy. Growth of the nominal money supply accelerated from 11% annually in second half 1974 to 14% in first half 1975 and should continue near that rate through 1976. This will permit governments to finance their massive budget deficits and to increase the availability of credit to the private sector. Because of waning inflation, the increase in nominal money supply will constitute a stronger impact on the real economy than in early 1975. In fact, we expect the combination of speeded up nominal money supply growth and slowing inflation in second half 1975 to yield the first half-yearly increase in real money balances in two years (see Table 1).

The Private Sector: Mixed Prospects

12. We expect private consumption to be the major source of growth in the Big Six, rising at 2% annually in first half 1976. In fact, private spending has the potential to become an even stronger stimulus. As unemployment stabilizes and large wage gains are realized, real incomes are rising more rapidly. With saving rates near all-time highs for more than a year (see Table 2), consumers in the

Table 1

Major Developed Countries: Changes in Real Money Supply[1]

Percent[2]

	1974	Projected 1975	1974 2d Half	1975 1st Half	Projected 1975 2d Half	Projected 1976 1st Half
Total	2.0	-1.1	-1.8	-3.5	4.6	2.9
Canada	6.5	7.3	10.3	8.6	2.2	2.3
France	3.3	3.0	2.7	1.9	5.9	4.8
Italy	1.5	-1.6	-0.4	-6.7[3]	8.0	7.0
Japan	-9.8	0.8	-7.3	3.2	4.8	2.6
United Kingdom	2.2	-12.9	-3.2	-20.6	-5.8	-5.4
West Germany	1.0	-3.4	-2.2	-9.7	9.2	4.0

1. Real money supply is defined as the sum of currency, checking accounts, and time deposits deflated by consumer prices.
2. Change from preceding period at an annual rate, seasonally adjusted.
3. Estimated.

Table 2

Major Developed Countries: Recent Trends in Saving Rates[1]

Percent

	1973	1974 Total	1974 1st Half	1974 2d Half	1975 1st Half
Canada	8.7	8.7	8.7	8.6	9.4
France[2]	13.3	12.1	N.A.	N.A.	N.A.
Italy	22.7	18.8	N.A.	N.A.	N.A.
Japan	22.5	24.3	24.9	23.7	23.7
United Kingdom	11.3	12.1	11.3	12.8	12.6
West Germany	14.1	14.8	13.8	15.8	16.8

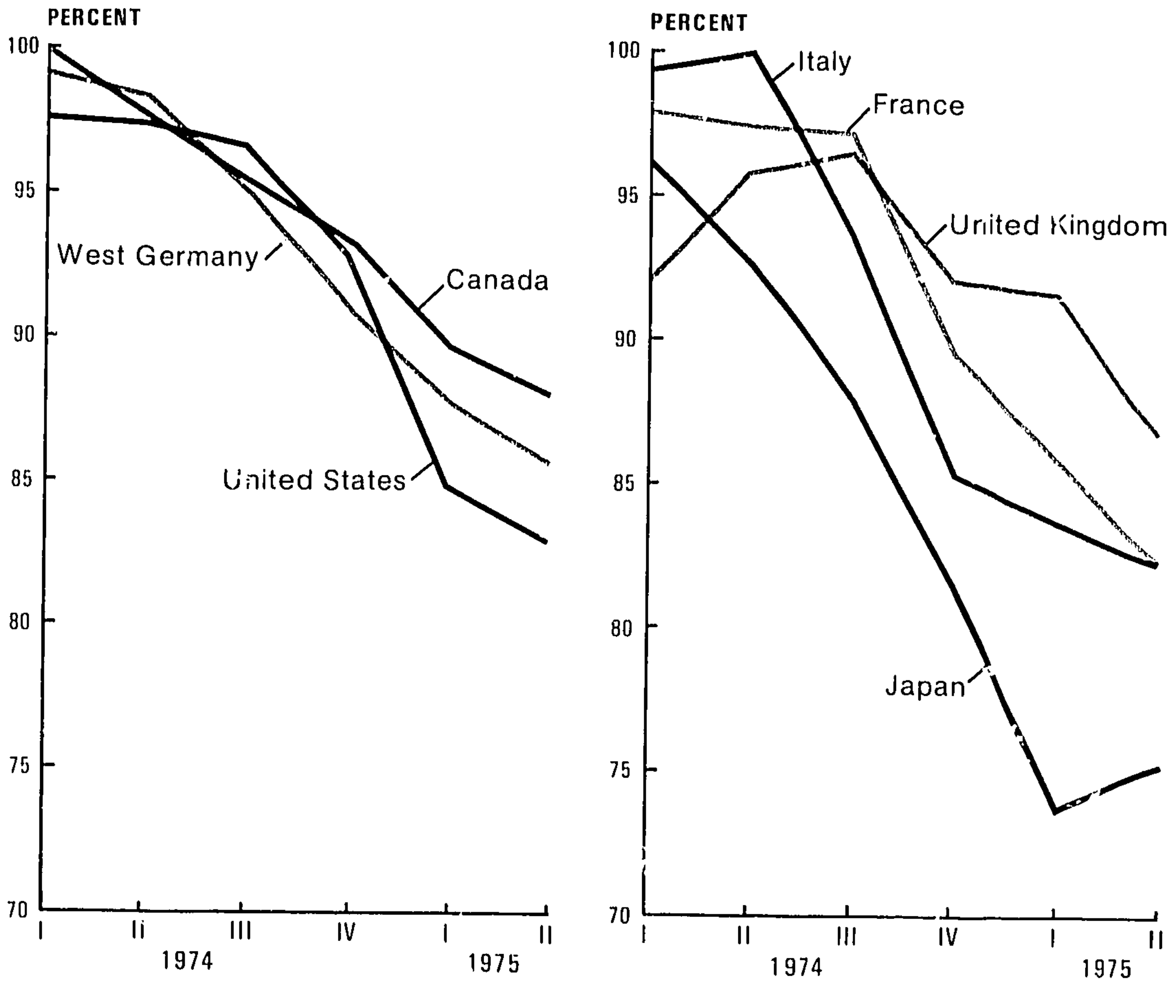
1. Personal savings as a percent of disposable personal incomes.
2. OECD estimate.

Big Six have considerable pent-up spending power. A surge in consumer confidence now would lead to a spurt in private consumption. We nevertheless judge that high unemployment and depressed real money balances will continue to make consumers cautious and to limit spending through mid-1976. At an annual rate of only 3-1/2%, private consumption will be most buoyant in Japan; it will perform worst in Britain, falling a like amount.

13. The outlook for investment in plant and equipment is particularly dismal. With substantial spare capacity in industry (see Figure 2) and slow growth expected

DEVELOPED COUNTRIES: Capacity Utilization[1]

Figure 2



1. We have estimated the trend in productive capacity by linear extrapolation through two postwar cyclical peaks in industrial production. This procedure yields a conservative estimate of capacity levels because some branches were not producing at full potential when the industrial sector as a whole reached its peak.

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in consumption, we do not expect much pickup in fixed investment over the forecast period. We foresee combined plant and equipment investment for the Six rising at an annual rate of only 1/2% in first half 1976, after three consecutive half years of decline (see Table 3). Prospects appear best in France, where business

Table 3

Major Developed Countries: Changes in Composite GNP and Components

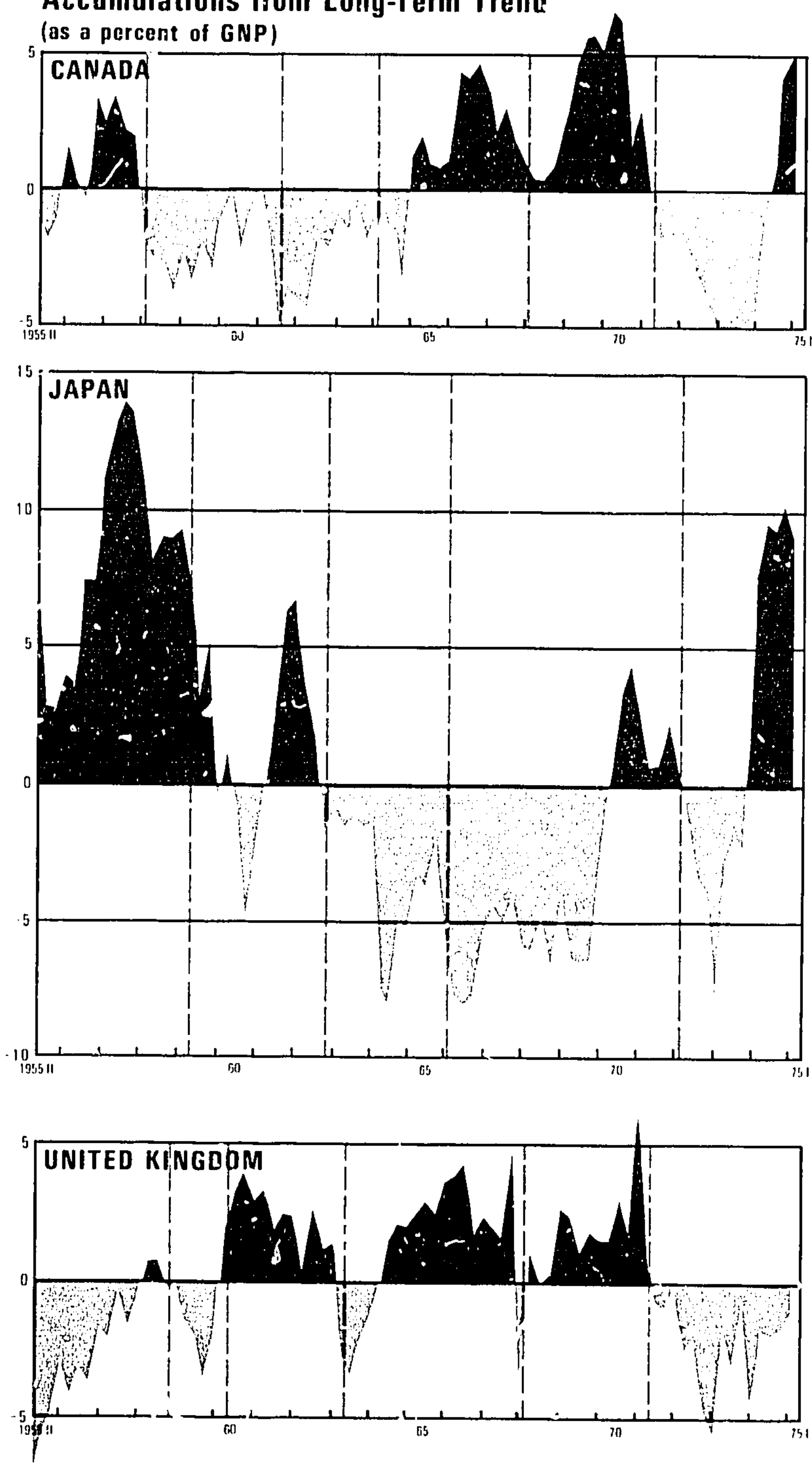
	1974	Projected 1975	1974 2d Half	1975 1st Half	Projected 1975 2d Half	Projected 1976 1st Half
	Percent[1]					
GNP	0.8	-1.8	0.5	-4.3	1.1	2.8
Private consumption	1.7	1.5	2.0	1.5	1.1	2.0
Government purchases	0.8	3.9	3.2	5.0	2.6	1.1
Consumption	3.8	2.6	4.1	1.5	3.2	2.4
Investment	-3.8	6.2	1.6	11.0	1.5	-1.1
Gross private fixed investment	-4.0	-7.0	-4.7	-10.7	-1.8	3.4
Plant and equipment	-3.4	-8.0	-4.9	-10.8	-5.7	0.3
Housing	-5.1	-5.4	-4.4	-10.7	4.8	8.5
Final domestic demand	0.3	0.1	0.8	-0.4	0.8	2.1
Exports of goods and services	11.5	-4.2	2.7	-10.0	1.3	4.6
Imports of goods and services	7.1	-5.2	-1.7	-12.0	6.2	4.8
Net foreign balance[2]	0.8	0.1	0.9	0.4	-0.9	....
Stockbuilding[2]	-0.3	-2.2	-1.2	-4.2	1.3	0.6
	Billion US $					
Actual change at annual rate	23.8	-7.5	19.5	-12.1	-3.9	0.6

1. Change from preceding period at an annual rate, seasonally adjusted.
2. Change is expressed as percent of GNP in previous period.

surveys point to a strong investment rebound next year; this reflects exceptionally tight capacity before the recession and spinoff from the 10% federal tax credit on investment orders placed before the end of 1975.

Figure 3

Developed Countries: Deviation of Inventory Accumulations from Long-Term Trend
(as a percent of GNP)



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Dashed vertical lines denote business cycle troughs.

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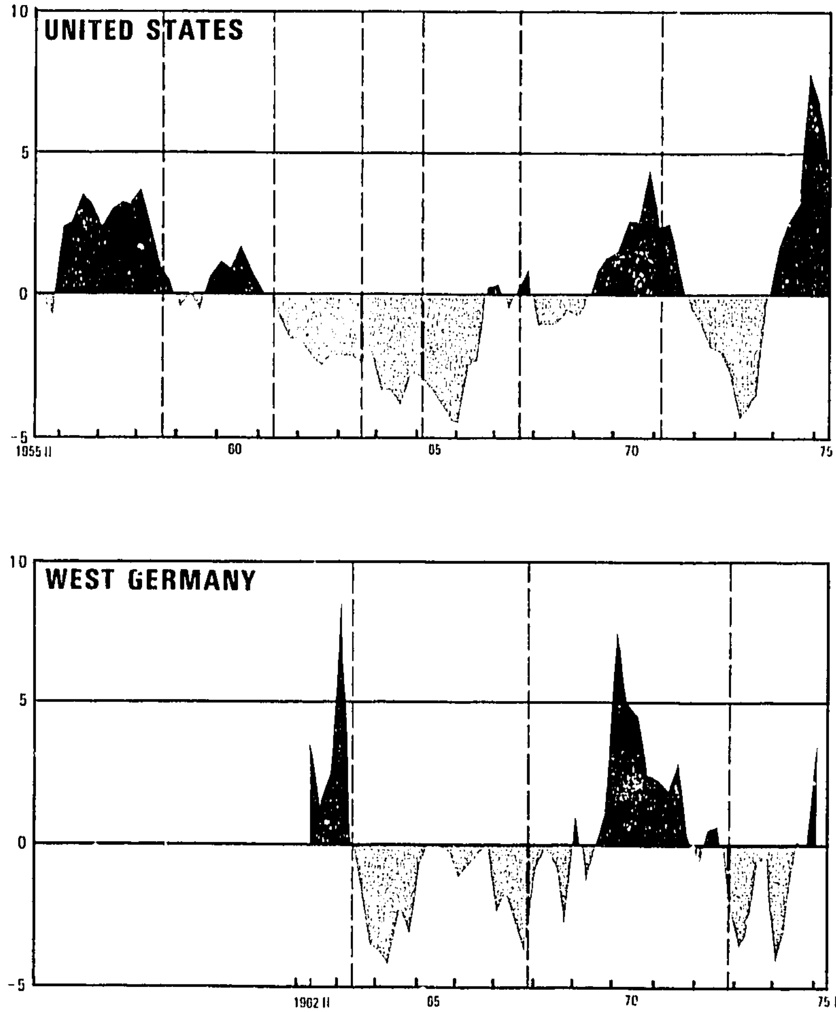
Figure 3 (Continued)



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Dashed vertical lines denote business cycle troughs.

Methodological Note

Because data on total stock levels are not available for most countries, direct examination of stock/demand relationships over several business cycles is not possible. To provide a rough intercyclical comparison, we have calculated the deviation of actual stock accumulation from the trend since 1955 (1962 for West Germany). The trend was derived by a least squares regression of cumulative stock changes on cumulative final demand changes from the base period to the present. The deviation of actual cumulative stock changes from the trend measures the extent to which there has been surplus or deficit accumulation of stocks in relation to demand since the base period. The deviations are expressed as shares of GNP in each quarter.

14. In contrast, prospects for housing investment are moderately good. For the Six as a group, we expect a 5% increase (annual rate) in housing construction in the current half, followed by a 9% rate in first half 1976. Sharp gains in real income, slowed increases in new home prices, and some loosening in credit are the prime factors underlying the anticipated rebound. Japan, with its perennial housing shortage, should again lead the way – with a 28% annual rate of increase in the current half and perhaps 18% in first half 1976. The United Kingdom, where housing prices have fallen by 18% relative to disposable incomes since early 1974, will show a similarly rapid gain, the sole bright spot in this troubled economy.

15. We expect the remaining investment component – stockbuilding – to remain depressed during the forecast period. After falling sharply in first half 1975, we expect Big Six inventories to drop less steeply in the current half, then to rise at an annual rate of only $0.6 billion in early 1976. The high ratio of actual to desired stocks in most countries (see Figure 3) underlies the sluggish forecast. Despite the bleak outlook, stockbuilding will contribute an average of 1% to GNP growth in each half, as the rate of liquidation decreases in the current half and stockbuilding actually becomes positive in early 1976.

16. Little impetus to recovery is likely from exports of goods and services. For the Big Six, the volume of foreign sales is expected to rise at an annual rate of only 1-1/2% this half year and 4-1/2% next. Increased exports will stem largely from sales to one another -- Big Six imports should be up 5% to 6% each half. On a net basis, the foreign sector will actually dampen growth in second half 1975 somewhat as the rise in imports exceeds export growth. In first half 1976, the net balance is expected to add nothing to GNP growth.

Comparisons of Growth Projections

17. Comparison of our growth forecasts with those of the OECD and Chase Econometrics (a leading US private forecasting group which relies heavily on computer models) shows that we join OECD -- and disagree with Chase – in foreseeing relatively slow economic growth through mid-1976 (see Table 4). For the Big Six, we expect a GNP rise of 2% from first half 1975 to first half 1976 as does the OECD. While Chase does not make semi-annual forecasts for Italy, its growth expectations for the other five countries are three-fourths of a percentage point higher than those of the OECD and one point higher than ours.

18. The differences among the three forecasts are greater on a country-by-country basis. In particular, Chase and the OECD are substantially more

Table 4

Major Developed Countries:
Comparison of CIA, OECD, and Chase Feconometric
Forecasts of GNP Changes

Percent[1]

	1st Half 1976		
	CIA	OECD	Chase
	Nov	Oct	Nov
Total	1.8	2.2	N.A.
Canada	3.0	4.2	4.4
France	3.5	2.5	2.2
Italy	....	0.5	N.A.
Japan	3.7	4.1	6.8
United Kingdom	-2.0	-1.5	-2.7
West Germany	0.7	1.6	1.9
Total (excluding Italy)	2.1	2.4	3.1

1. Change from first half 1975.

optimistic than we for Canada and West Germany. Both OECD and Chase foresee Canadian private consumption growing at double our projection of 2.5% from first half 1975 to first half 1976. Chase apparently sees West German GNP being boosted by a drop in saving rates in first half 1976, while the OECD envisions a continued rise in government purchases -- both of which we regard as possible but improbable. On Japan, we join the OECD in limning a relatively grim recovery picture, while Chase expects a much stronger upturn. Both of the others are less optimistic than we on French prospects; OECD is in close agreement with us on stagnant Italian output. All three agree on a bleak economic outlook for the United Kingdom.

Inflation: Steady Rate

19. Inflation, having declined to a combined rate of 9%, is unlikely to change much through the middle of next year (see Table 5). In recent months, sluggish demand has cut raw material prices, forced businesses to accept narrowed profit margins, and in some cases induced labor to hold down wage demands. Authorities have exercised restraint in expanding the money supply. Our predicted rise in consumer prices for the Six -- a 9% annual rate in first half 1976 -- nonetheless is far above historic rates. Over the longer pull, food supply problems, additional oil price hikes, structural adjustments resulting from high energy costs, and stronger political pressures to boost incomes could complicate the battle against inflation.

Table 5

Major Developed Countries: Changes in Consumer Prices

Percent[1]

	1974	Projected 1975	1974 2d Half	1975 1st Half	Projected 1975 2d Half	Projected 1976 1st Half
Total	**15.6**	**12.0**	**13.7**	**12.7**	**8.9**	**8.9**
Canada	10.9	10.0	11.0	9.7	9.6	8.0
France	13.7	11.7	14.4	11.5	9.2	9.2
Italy	19.4	16.7	28.0	16.0	8.5	9.0
Japan	24.4	11.3	17.6	11.1	6.0	8.0
United Kingdom	16.0	24.3	16.2	28.7	23.8	16.6
West Germany	7.0	5.9	4.9	7.2	4.4	6.1

1. Change from previous period at an annual rate.

20. In first half 1976, West Germany will continue its enviable price performance; the acceleration from 4-1/2% in second half 1975 to a 6% inflation rate mainly reflects seasonal factors. Britain again will post the worst record, even though the 17% rate forecast represents a marked improvement from the 24% average of 1975. The remaining countries should manage to stay within the single-digit range, thanks to the continued weakness of demand and to government controls. In Canada, newly instituted government wage-price controls probably will slow the inflation rate from 10% in 1975 to 8% in first half 1976.

Current Account: Back into Deficit

21. We expect the combined current account balance of the Big Six to deteriorate sharply in the year ending June 1976. This worsening from a small deficit in first half 1975 to a $6.5 billion deficit in second half 1975 and a $7.3 billion deficit in first half 1976 stems largely from weakening in the trade accounts (see Table 6).

22. In most countries, swings in merchandise trade positions will be affected more by volume than by price changes. After an abrupt decline, we expect import volume to expand at a 7.5% annual rate in the current half year and at a 6% rate in first half 1976. Oil imports are rising substantially from the depressed level of early 1975, when stocks were being drawn down, and the revival of production is pulling in raw materials from abroad.

Table 6

Major Developed Countries: Trade and Current Account Balances

Billion US $

	1974		Projected 1975		1974 2d Half		1975 1st Half		Projected: 1975 2d Half		Projected: 1976 1st Half	
	Trade	Current Account	Trade	Current Account	Trade	Current Account	Trade	Current Account	Trade	Current Account	Trade	Current Account
Total	**2.5**	**-18.3**	**18.1**	**-7.1**	**2.9**	**-6.7**	**11.8**	**-0.6**	**6.2**	**-6.5**	**5.9**	**-7.3**
Canada	1.5	-1.7	-1.2	-5.0	0.2	-1.5	-0.7	-2.6	-0.5	-2.4	-0.2	-2.2
France	-3.3	-5.8	1.5	-1.5	-1.7	-2.8	1.5	0.1	-0.1	-1.6	-0.8	-2.2
Italy	-8.0	-7.8	....	-0.6	-3.7	-2.9	0.2	-0.2	-0.2	-0.4	-0.4	-0.6
Japan	1.6	-4.0	5.8	-0.5	2.8	0.3	3.9	0.8	1.9	-1.3	1.9	-1.6
United Kingdom	-12.3	-8.8	-7.2	-4.2	-6.2	-4.4	-3.8	-2.1	-3.4	-2.0	-3.5	-2.2
West Germany	23.0	9.8	19.2	4.6	11.5	4.6	10.7	3.4	8.5	1.2	8.9	1.5

23. We believe France, Italy, Japan, and West Germany will follow similar import patterns, with volume increasing at a 10% annual rate in second half 1975 and somewhat less rapidly in early 1976. In Canada, which is less dependent on foreign supplies of raw materials and oil, imports will grow much more slowly. British imports will show only moderate change as economic recovery lags behind other countries.

24. The volume of exports, which consist in large part of finished manufactured goods, will recover more slowly than imports. We expect annual growth in export volume for the Six to measure less than 3% in second half 1975 and 4.5% in first half 1976. Export performance will vary considerably among countries.

25. Britain will suffer a further decline in export volume this half. British inflation has more than offset depreciation of the pound. We expect French export volume to stagnate in the coming months. Firming world demand should begin to stimulate export volume in Canada, Italy, West Germany, and Japan in second half 1975 -- a trend we expect will accelerate in 1976.

26. Price adjustments are expected to be particularly important factors determining changes in the West German and British trade positions (see Table 7). An adverse movement in terms of trade, together with the decline in the dollar value of the Deutschemark, should account for 70% of the $2.2 billion decline in the West German trade surplus in second half 1975. Only a small part of this deterioration will be recouped in first half 1976. An improvement in Britain's terms

Table 7

Major Developed Countries: Projected Changes in Current Account Components

Billion US $

	1975 1st Half to 1975 2d Half					1975 2d Half to 1976 1st Half				
	Trade Balance					Trade Balance				
		Attributable to					Attributable to			
	Total	Volume	Terms of Trade	Services Balance	Current Account Balance	Total	Volume	Terms of Trade	Service Balance	Current Account Balance
Total	-5.6	-5.5	-0.1	-0.3	-5.9	-0.3	-0.3	....	-0.5	-0.8
Canada	0.2	0.3	-0.1	....	0.2	0.3	0.3	....	-0.1	0.2
France	-1.6	-1.2	-0.4	-0.1	-1.7	-0.7	-0.9	0.2	0.1	-0.6
Italy	-0.4	....	-0.4	0.2	-0.2	-0.2	-0.2	....	....	-0.2
Japan	-2.0	-2.1	0.1	-0.1	-2.1	....	0.1	-0.1	-0.3	-0.3
United Kingdom	0.4	-1.2	1.6	-0.3	0.1	-0.1	0.3	-0.4	-0.1	-0.2
West Germany	-2.2	-1.3	-0.9	....	-2.2	0.4	0.1	0.3	-0.1	0.3

of trade accounts for all of the strengthening in its trade balance in second half 1975; we expect a slight worsening in the British terms of trade in early 1976.

Worsened Payments with OPEC

27. About one-third of the $5.9 billion drop in the combined current account balance of the Six in second half 1975 will be due to a deterioration in their payments position with OPEC. The pickup in oil imports at slightly higher prices, coupled with increased interest payments, will add $4.4 billion to payments to OPEC; increased exports to OPEC will total about $2 billion. We also expect the trade balance with the non-oil LDCs to deteriorate markedly in second half 1975 as the volume of raw material imports increases and exports to the LDCs slow. Big Six trade with the smaller OECD countries will deteriorate somewhat in second half 1975 as growth in some of these countries slows. In first half 1976, a further $0.8 billion deterioration in the current account balance of the Six is expected, primarily because of higher oil payments.

Financing the Deficit

28. We believe that the Big Six will have little difficulty financing the expected increase in their current account deficits. Japan and France will be able to borrow in the Eurodollar market to cover their financing needs. Because of its large resource base and small debt service payments, Canada retains an excellent credit rating in the face of what is now the largest current account deficit among major developed countries. It will continue to meet much of its requirements through public borrowing in New York and on the Eurodollar market.

29. Italy will continue to lean heavily on the IMF to cover its payments deficit. In March, Rome drew down $400 million of its standby credit and recently drew an additional $900 million from the special IMF Oil Facility. Next year, it is expected to tap the Oil Facility for another $400 million and possibly draw on the EC oil borrowing arrangement, if it is activated, for another $750 million. Any residual needs can be handled by reserve drawdowns.

30. After increasing their investments in first quarter 1975, OPEC countries began to pull out of sterling in the second quarter. Prospects are for continued outflows until British inflation is clearly under control. London should still be able to borrow enough to cover the current account deficit through mid-1976 without great difficulty. In recent weeks, it drew down $400 million of a longstanding credit line with Iran and has the option to draw a further $400 million next year. Oil company investments in the North Sea also will provide a sizable capital inflow over the 12 months to mid-1976.

31. In order to buttress its position, London has applied to the IMF for a loan of approximately $2 billion. More than half of the loan -- $1.2 billion -- will come from the Oil Facility; the remaining $0.8 billion will come from Britain's normal credit rights in the IMF. With its anti-inflation program now firmly in place, Britain should have no trouble meeting the conditions the IMF is likely to require in granting the loan.

Major Uncertainties

32. In contrast to our past forecasting efforts, we believe that the risk of underestimating growth prospects is greater than chances of overestimating in at least half the Big Six. In particular, a return to more normal saving rates would mean that our estimate of domestic demand was too low. The timing of the inevitable turnaround in saving rates is difficult to gauge, depending as it does

on consumer perceptions of employment opportunities and on other even more nebulous factors that determine confidence levels. Our estimates for West Germany and Japan are particularly vulnerable on this score.

33. If recent progress in fighting inflation substantially scales down expectations of future price changes, consumer price increases could slow in first half 1976. A belief that the back of inflation had been broken might induce labor unions to be more moderate in wage demands, producers to restrain price hikes, and lenders to cut back interest rates.

34. Exchange rate movements are the major uncertainty in our current account estimates. We have assumed that exchange rate changes will be small, mainly reflecting differences in inflation rates. Larger, short-run swings in currency rates due to interest-sensitive capital flows are possible; these would distort our estimates of export and import flows, particularly as measured in dollars.

Canada: Changes in Real GNP, Components, and Selected Key Domestic Indicators

Percent[1]

	1974	Projected 1975	1974 2d Half	1975 1st Half	Projected 1975 2d Half	Projected 1976 1st Half
GNP	2.8	-1.0	-0.5	-2.7	1.9	4.2
Private consumption	4.2	1.4	1.0	1.3	2.2	3.0
Government purchases	7.9	4.2	6.0	4.9	1.3	1.3
Consumption	8.0	3.1	4.2	3.6	1.0	1.0
Investment	7.5	10.1	15.6	11.3	3.0	3.0
Gross fixed private investment	5.1	-0.3	-7.2	1.8	2.8	3.0
Plant and equipment	7.9	5.5	0.1	10.0	2.0	....
Housing	-2.6	-17.4	-26.0	-22.6	6.0	14.5
Final domestic demand	5.2	1.7	0.5	2.2	2.1	2.6
Exports of goods and services	-3.9	-7.0	-0.4	-14.6	3.0	6.1
Imports of goods and services	8.6	-3.4	7.3	-10.7	1.8	2.8
Net foreign balance[2]	-3.1	-0.7	-2.0	-0.5	0.3	0.7
Stockbuilding[2]	0.5	-2.1	0.5	-4.2	-0.5	0.8
Actual change in stocks, annual rate (billion 1973 US $)	*2.3*	*-0.3*	*2.5*	*-0.1*	*-0.5*	*0.1*
Industrial production	2.6	-4.4	-4.6	-7.3	2.0	3.0
Consumer prices[3]	10.9	10.0	11.0	9.7	9.6	8.0
Wholesale industrial prices[3]	21.5	9.5	11.7	10.2	6.0	6.0
Money supply (M1)	9.8	11.4	2.2	16.0	12.0	8.2
Wage rates	13.5	16.2	19.6	15.9	13.5	10.0

1. Unless otherwise indicated, change from preceding period at an annual rate, seasonally adjusted.
2. Change is expressed as a percent of GNP in previous period.
3. Not seasonally adjusted.

Canada: Current Account Trends[1]

	1974	Projected 1975	1974 2d Half	1975 1st Half	Projected 1975 2d Half	Projected 1976 1st Half
	Billion US $[2]					
Exports (f.o.b.)	33.0	32.8	17.2	16.0	16.8	18.2
Imports (f.o.b.)	31.5	34.0	17.0	16.7	17.3	18.4
Trade balance	1.5	-1.2	0.2	-0.7	-0.5	-0.2
Net services and transfers	-3.2	-3.8	-1.7	-1.9	-1.9	-2.0
Current account balance	-1.7	-5.0	-1.5	-2.6	-2.4	-2.2
	Percent Change from Previous Period Half-Year Data at an Annual Rate					
Export volume	-5.0	-7.4	1.1	-16.5	4.5	7.2
Export prices in terms of US dollars	37.9	6.9	15.3	3.3	6.1	10.2
Import volume	10.3	-5.8	7.7	-14.7	0.6	3.0
Import prices in terms of US dollars	29.9	14.4	25.6	12.9	7.2	10.3

1. Half-year data, seasonally adjusted.
2. Canadian dollar values were converted at the following exchange rates: 0.9726 Canadian dollar to the US dollar in first half 1974, 0.9834 in second half 1974, 1.0101 in first half 1975, 1.0246 in second half 1975, and 1.0152 in first half 1976.

Approved For Release 2005/01/10 : CIA-RDP86T00608R000500200023-1

France: Changes in Real GNP, Components, and Selected Key Domestic Indicators

Percent[1]

	1974	Projected 1975	1974 2d Half	1975 1st Half	Projected 1975 2d Half	Projected 1976 1st Half
GNP	3.9	-3.7	-0.2	-8.7	2.7	4.3
Private consumption	4.3	1.8	2.0	1.8	1.6	2.7
Government purchases	2.6	2.5	1.9	2.0	4.3	4.4
Consumption	3.5	1.8	3.6	0.4	2.8	3.6
Investment	0.5	4.1	-1.6	5.5	7.3	6.1
Gross fixed private investment	3.9	-9.3	0.1	-16.2	-3.6	3.8
Plant and equipment	3.8	-10.1	....	-16.6	-6.1	4.3
Housing	4.2	-7.8	0.3	-15.5	1.0	3.0
Final domestic demand	3.9	-0.2	1.6	-2.0	1.1	3.6
Exports of goods and services	1.8	-4.5	-2.4	-6.9	-1.5	1.2
Imports of goods and services	8.9	-10.1	-9.7	-16.8	4.7	6.3
Net foreign balances[2]	0.6	0.9	1.5	2.0	-1.6	-1.0
Stockbuilding[2]	0.6	-4.3	-3.3	-8.7	3.6	2.0
Actual change in stocks, annual rate (billion 1973 US $)	*4.6*	*-7.8*	*2.4*	*-8.0*	*-3.4*	*-1.4*
Industrial production	2.8	-9.2	-4.2	-15.0	-2.0	6.0
Consumer prices[3]	13.7	11.7	14.4	11.5	9.2	9.2
Wholesale industrial prices[3]	29.1	4.5	22.4	2.0	-6.0	2.9
Money supply (M1)	10.7	15.0	15.3	14.5	15.6	14.5
Wage rates	18.8	17.3	23.0	16.0	14.7	13.4

1. Unless otherwise indicated, change from preceding period at an annual rate, seasonally adjusted.
2. Change is expressed as a percent of GNP in previous period.
3. Not seasonally adjusted.

France: Current Account Trends[1]

	1974	Pro-jected 1975	1974 2d Half	1975 1st Half	Projected 1975 2d Half	Projected 1976 1st Half
	Billion US $[2]					
Exports (f.o.b.)	46.6	53.5	24.5	27.4	26.1	26.0
Imports (f.o.b.)	49.9	52.0	26.2	25.9	26.2	26.8
Trade balance	-3.3	1.5	-1.7	1.5	-0.1	-0.8
Net services and transfers	-2.5	-3.0	-1.1	-1.4	-1.5	-1.4
Current account balance	-5.8	-1.5	-2.8	0.1	-1.6	-2.2
	Percent Change from Previous Period Half-Year Data at an Annual Rate					
Export volume	9.6	-5.9	-8.1	-7.5	....	1.2
Export prices in terms of US dollars	15.7	18.9	33.9	28.5	-8.8	-1.3
Import volume	6.8	-8.7	-2.9	-19.3	9.8	7.7
Import prices in terms of US dollars	37.6	14.2	40.1	14.5	-6.2	-2.2

1. Half-year data, seasonally adjusted.
2. French franc values were converted at the following exchange rates: 4.89 French francs to the US dollar in first half 1974, 4.71 in second half 1974, 4.18 in first half 1975, 4.35 in second half 1975, and 4.50 in first half 1976.

Italy: Changes in Real GNP, Components, and Selected Key Domestic Indicators

Percent[1]

					Projected	
	1974	Projected 1975	1974 2d Half	1975 1st Half	1975 2d Half	1976 1st Half
GNP	3.4	-4.6	-6.7	-4.8	-2.1	2.0
Private consumption	2.3	-2.9	-6.5	-2.0	-1.0	1.0
Government purchases	-3.1	-1.7	-7.3	-0.3	1.3	2.5
Consumption	2.1	0.6	-0.6	1.0	1.0	2.0
Investment	-15.1	-8.1	-23.4	-4.0	2.0	4.0
Gross fixed private investment	13.4	-14.3	-3.9	-18.7	-15.2	-0.1
Plant and equipment	19.3	-23.1	-5.9	-29.4	-26.0	-2.0
Housing	5.1	-0.3	-0.6	-0.4	0.4	2.0
Final domestic demand	2.8	-4.5	-6.2	-4.5	-2.7	1.2
Exports of goods and services	16.1	-5.8	1.4	-14.4	6.1	6.1
Imports of goods and services	10.3	-11.7	-15.9	-19.0	10.3	4.0
Net foreign balance[2]	0.7	1.3	3.3	1.1	-0.8	0.3
Stockbuilding[2]	-0.3	-1.4	-3.8	-1.4	1.2	0.5
Actual change in stocks, annual rate (billion 1973 US $)	*1.4*	*-0.6*	*0.6*	*-1.0*	*-0.2*	*0.1*
Industrial production	4.3	-9.7	-12.5	-10.5	-5.0	3.0
Consumer prices[3]	19.4	16.7	28.0	16.0	8.5	9.0
Wholesale industrial prices[3]	45.5	7.5	27.9	1.8	1.6	2.4
Money supply (M1)	19.3	14.1	10.7	14.2	17.2	16.6
Wage rates	22.5	27.5	27.7	28.8	25.0	25.0

1. Unless otherwise indicated, change from preceding period at an annual rate, seasonally adjusted.
2. Change is expressed as a percent of GNP in previous period.
3. Not seasonally adjusted.

Italy: Current Account Trends[1]

	1974	Projected 1975	1974 2d Half	1975 1st Half	Projected 1975 2d Half	Projected 1976 1st Half
	Billion US $[2]					
Exports (f.o.b.)	30.0	33.3	16.4	17.0	16.3	16.9
Imports (f.o.b.)	38.0	33.3	20.1	16.8	16.5	17.3
Trade balance	-8.0	....	-3.7	0.2	-0.2	-0.4
Net services and transfers	0.2	-0.6	0.8	-0.4	-0.2	-0.2
Current account balance	-7.8	-0.6	-2.9	-0.2	-0.4	-0.6
	Percent Change from Previous Period Half-Year Data at an Annual Rate					
Export volume	7.3	-0.9	18.5	-13.8	10.0	5.8
Export prices in terms of US dollars	25.5	9.1	30.3	14.5	-16.7	1.6
Import volume	-5.5	-15.6	-5.8	-30.0	10.0	8.4
Import prices in terms of US dollars	55.3	5.0	25.4	5.5	-12.7	1.6

1. Half-year data, not seasonally adjusted.
2. Italian lira values were converted at the following exchange rates: 642.1 Italian lira to the US dollar in first half 1974, 658.6 in second half 1974, 633.23 in first half 1975, 675.0 in second half 1975, and 690 in first half 1976.

Japan: Changes in Real GNP, Components, and Selected Key Domestic Indicators

Percent[1]

	1974	Projected 1975	1974 2d Half	1975 1st Half	Projected 1975 2d Half	Projected 1976 1st Half
GNP	-1.7	1.5	3.2	-0.3	3.0	4.4
Private consumption	1.1	3.6	5.1	3.4	2.4	3.6
Government purchases	-4.9	9.2	6.1	13.2	4.9	3.5
Consumption	3.2	4.0	5.9	0.2	10.0	8.0
Investment	-12.5	15.0	6.3	28.4	....	-1.0
Gross fixed private investment	-9.2	-4.8	-4.2	-8.7	2.8	7.2
Plant and equipment	-10.3	-8.6	-11.3	-9.4	-4.0	2.0
Housing	-6.5	3.3	13.0	-7.3	28.0	17.2
Final domestic demand	-3.0	2.4	2.7	2.0	3.0	4.5
Exports of goods and services	20.7	6.7	25.4	-1.0	6.0	5.9
Imports of goods and services	12.1	-7.3	-0.4	-16.5	6.5	6.9
Net foreign balance[2]	0.9	1.8	3.2	2.1	....	-0.1
Stockbuilding[2]	0.3	-2.7	-2.6	-4.3	....	....
Actual change in stocks, annual rate (billion 1973 US $)	*13.9*	*2.5*	*11.3*	*2.5*	*2.5*	*2.5*
Industrial production	-2.6	-9.9	-13.8	-17.6	12.7	9.0
Consumer prices[3]	24.4	11.3	17.6	11.1	6.0	8.0
Wholesale industrial prices[3]	31.4	3.0	10.9	-0.3	2.3	0.7
Money supply (M1)	13.1	11.1	9.8	11.8	11.1	10.8
Wage rates	32.8	17.9	35.8	15.3	8.3	12.0

1. Unless otherwise indicated, change from preceding period at an annual rate, seasonally adjusted.
2. Change is expressed as a percent of GNP in previous period.
3. Not seasonally adjusted.

Japan: Current Account Trends[1]

	1974	Projected 1975	1974 2d Half	1975 1st Half	Projected 1975 2d Half	Projected 1976 1st Half
	Billion US $[2]					
Exports (f.o.b.)	54.5	55.9	29.5	28.3	27.6	28.9
Imports (f.o.b.)	52.9	50.1	26.7	24.4	25.7	27.0
Trade balance	1.6	5.8	2.8	3.9	1.9	1.9
Net services and transfers	-5.6	-6.3	-2.5	-3.1	-3.2	-3.5
Current account balance	-4.0	-0.5	0.3	0.8	-1.3	-1.6
	Percent Change from Previous Period Half-Year Data at an Annual Rate					
Export volume	16.1	1.0	22.4	-10.4	6.5	7.1
Export prices in terms of US dollars	28.7	-1.1	15.2	-3.6	-10.7	2.4
Import volume	-0.5	-11.2	-13.5	-23.2	6.5	6.5
Import prices in terms of US dollars	63.9	8.0	32.3	....	4.0	3.6

1. Half-year data, seasonally adjusted.
2. Yen values were converted at the following exchange rates: 280.1 Japanese yen to the US dollar in first half 1974, 299.8 in second half 1974, 293.1 in first half 1975, and 300 in second half 1975 and first half 1976.

United Kingdom: Changes in Real GNP, Components, and Selected Key Domestic Indicators

Percent[1]

	1974	Projected 1975	1974 2d Half	1975 1st Half	Projected 1975 2d Half	Projected 1976 1st Half
GNP	0.4	-1.5	6.9	-4.5	-3.6	-0.5
Private consumption	-0.1	-0.3	4.8	-1.1	-3.8	-3.0
Government purchases	2.0	2.4	1.5	4.1	0.1	-0.7
Consumption	2.1	2.9	3.9	3.6	0.5	2.0
Investment	1.6	1.2	-4.5	5.3	-1.0	-7.5
Gross fixed private investment	-4.4	-7.3	0.8	-10.2	-9.2	-8.1
Plant and equipment	-0.9	-10.2	3.9	-13.3	-17.0	-14.1
Housing	-19.2	7.9	-14.0	8.0	34.1	16.9
Final domestic demand	....	-0.4	3.5	-0.8	-3.3	-2.9
Exports of goods and services	5.9	-3.0	-1.1	-2.6	-5.9	4.0
Imports of goods and services	0.8	-7.2	-3.0	-9.7	6.1	....
Net foreign balance[2]	1.2	0.3	0.5	1.8	-2.9	1.0
Stockbuilding[2]	-0.7	-1.4	3.0	-5.4	2.6	1.6
Actual change in stocks, annual rate (billion 1973 US $)	*0.9*	*-1.6*	*2.2*	*-2.8*	*-0.5*	*0.9*
Industrial production	-2.3	-7.4	5.8	-14.1	-5.7	2.0
Consumer prices[3]	16.0	24.3	16.2	28.7	23.8	16.6
Wholesale industrial prices[3]	29.1	25.0	24.9	27.3	20.7	12.4
Money supply (M1)	3.5	14.8	8.2	17.1	16.6	10.3
Wage rates	16.2	24.4	29.5	26.4	16.5	10.3

1. Unless otherwise indicated, change from preceding period at an annual rate, seasonally adjusted.
2. Change is expressed as a percent of GNP in previous period.
3. Not seasonally adjusted.

Approved For Release 2005/01/10 : CIA-RDP86T00608R000500200023-1

United Kingdom: Current Account Trends[1]

	1974	Projected 1975	1974 2d Half	1975 1st Half	Projected 1975 2d Half	Projected 1976 1st Half
	Billion US $[2]					
Exports (f.o.b.)	36.5	43.8	19.2	22.2	21.6	22.1
Imports (f.o.b.)	48.8	51.0	25.4	26.0	25.0	25.6
Trade balance	-12.3	-7.2	-6.2	-3.8	-3.4	-3.5
Net services and transfers	3.5	3.1	1.8	1.7	1.4	1.3
Current account balance	-8.8	-4.1	-4.4	-2.1	-2.0	-2.2
	Percent Change from Previous Period Half-Year Data at an Annual Rate					
Export volume	7.1	....	-1.6	4.0	-5.9	6.1
Export prices in terms of US dollars	21.7	16.3	23.7	22.0	....	0.8
Import volume	1.3	-7.1	-3.8	-13.7	4.0	3.0
Import prices in terms of US dollars	13.2	7.3	21.1	11.4	-11.6	4.0

1. Half-year data, seasonally adjusted.
2. British pound values were converted at the following exchange rates: 0.428 British pound to the US dollar in first half 1974, 0.427 in second half 1974, 0.424 in first half 1975, 0.472 in second half 1975, and 0.495 in first half 1976.

West Germany: Changes in Real GNP, Components, and Selected Key Domestic Indicators

Percent[1]

	1974	Projected 1975	1974 2d Half	1975 1st Half	Projected 1975 2d Half	Projected 1976 1st Half
GNP	0.4	-3.3	-1.8	-6.0	0.4	1.0
Private consumption	0.2	2.1	1.7	2.3	2.4	2.4
Government purchases	4.8	2.1	5.4	0.9	1.4	-3.7
Consumption	4.8	2.1	5.4	0.9	1.4	-3.7
Investment	4.8	2.1	5.4	0.9	1.4	-3.7
Gross fixed private investment	-8.2	-9.0	-9.2	-11.9	-2.5	1.8
Plant and equipment	-8.0	-5.6	-1.7	-10.2	....	....
Housing	-8.3	-11.5	-14.4	-13.3	-4.4	3.3
Final domestic demand	-1.1	-0.5	-0.3	-1.4	1.1	1.0
Exports of goods and services	13.3	8.3	-3.2	17.8	2.5	5.1
Imports of goods and services	4.9	0.5	5.8	-5.3	8.2	6.1
Net foreign balance[2]	2.3	-2.7	-2.2	-3.7	-1.2	-0.2
Stockbuilding[2]	-0.9	-0.2	0.7	-0.9	0.5	0.2
Actual change in stocks, annual rate (billion 1973 US $)	*0.5*	*-0.2*	*1.0*	*-0.5*	*0.2*	*0.5*
Industrial production	-1.3	-7.5	-7.6	-10.4	-0.7	4.6
Consumer prices[3]	7.0	5.9	4.9	7.2	4.4	6.1
Wholesale industrial prices[3]	13.4	1.8	4.1	1.6	....	2.0
Money supply (M1)	5.9	13.3	12.6	13.2	14.0	10.0
Wage rates	12.0	10.1	21.2	5.1	10.0	6.3

1. Unless otherwise indicated, change from preceding period at an annual rate, seasonally adjusted.
2. Change is expressed as a percent of GNP in previous period.
3. Not seasonally adjusted.

West Germany: Current Account Trends[1]

	1974	Projected 1975	1974 2d Half	1975 1st Half	Projected 1975 2d Half	Projected 1976 1st Half
	Billion US $[2]					
Exports (f.o.b.)	88.9	90.3	46.3	46.3	44.0	47.3
Imports (f.o.b.)	65.9	71.1	34.8	35.6	35.5	38.4
Trade balance	23.0	19.2	11.5	10.7	8.5	8.9
Net services and transfers	-13.2	-14.6	-6.9	-7.3	-7.3	-7.4
Current account balance	9.8	4.6	4.6	3.4	1.2	1.5
	Percent Change from Previous Period Half-Year Data at an Annual Rate					
Export volume	12.2	-11.3	-2.0	-21.5	2.4	5.0
Export prices in terms of US dollars	18.6	12.9	20.1	24.3	-12.1	10.3
Import volume	-1.2	1.6	10.6	-6.6	10.5	6.0
Import prices in terms of US dollars	29.1	4.8	12.8	9.2	-10.2	10.3

1. Half-year data, seasonally adjusted.
2. German mark values were converted at the following exchange rates: 2.62 German marks to the US dollar in first half 1974, 2.57 in second half 1974, 2.35 in first half 1975, 2.55 in second half 1975, and 2.50 in first half 1976.